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In The
Supreme Court of the United States
October Term, 1995

LELAND A. COOPER, ET AL.
PETITIONERS

v.

COMMISSIONER OF REVENUE OF MASSACHUSETTS
RESPONDENT

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME JUDICIAL COURT FOR THE COMMONWEALTH OF MASSACHUSETTS

PETITION FOR WRIT OF CERTIORARI

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34 pp

QUESTION PRESENTED

Does Massachusetts's policy of requiring federal military retirees to pay state income tax on their retirement benefits while completely exempting from state tax the retirement benefits of all state and municipal retirees violate 4 USC §111 which prohibits states from taxing federal employees in a discriminatory fashion?

LIST OF PARTIES

The parties to the proceeding below were the 28 petitioners: Kenneth and Mary Depperman, Kenneth Cadran, Leland Cooper, Norman and Rosa Cupfender, Robert and Annetta Davenport, William and Junko Feddema, David Flanagan, William and Diane Flanagan, Peter and Delores Haritos, William and Rhoda Hurley, Ralph and Joan Jacobson, Selma Levine, Antonio Maglione, Jr., Kent and Eleanor Mathews, Leslie Mears, Bernie Thompson, William Wroblicka, John Thurston and Kenneth E. Bixby, Jr. who are all federal military retirees, their spouses or dependents. The respondent before the Court is the Commissioner of Revenue of the Commonwealth of Massachusetts.

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TO THE HONORABLE, THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES

Petitioners Leland A. Cooper, et al. respectfully pray that a writ of certiorari issue to review the judgment and opinion of the Supreme Judicial Court for the Commonwealth of Massachusetts, entered in the above-titled case on December 26, 1995.

OPINION BELOW

The opinion of the Supreme Judicial Court is reported at 421 Mass. 557 (1995) and is reprinted in the Appendix at A. 3-8.

JURISDICTION

The jurisdiction of this Court to review the judgment of the Supreme Judicial Court is invoked pursuant to 28 U.S.C. § 1257.

STATUTE INVOLVED

This case involves 4 USC § 111 which provides, in material part, as follows:

> The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States, . . . if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

STATEMENT OF THE CASE

Preliminary Statement

This case involves 19 veterans, spouses and dependents[1] upon whose military retirement benefits Massachusetts has levied an illegal tax. Petitioners raise only one issue: when Massachusetts "taxes the benefits received from the United States by military

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1. Originally 19 separate cases (involving a total of 28 taxpayers) were consolidated and decided by the Massachusetts Appellate Tax Board. A. 1-2. The veterans filed a single appeal from that decision and the Supreme Judicial Court issued one opinion. A. 3-8.

retirees but does not tax the benefits received by retired state and local government employees . . . ," is it violating federal law? See Barker v. Kansas, 503 U.S. 594, 118 L.Ed. 2d 243, 248 (1992). In Barker this Court answered that very question in the affirmative. Petitioners suggest the same answer applies here.

Statement of Facts and Prior Proceedings

Petitioners are all residents of the Commonwealth who received income from military retirement benefits for some or all of the tax years 1986 to 1992 (the "veterans"). Appendix ("A.") 4. Each paid Massachusetts income tax on that retirement income and each filed timely abatement appeals with the Massachusetts Appellate Tax Board. A. 1-2. Before the Board, the Commissioner made a motion to "dismiss on the pleadings" all of those appeals. A. 8, n. 4. His motion was based solely on the prior decision of the Supreme Judicial Court in Filios v. Commissioner of Revenue, 415 Mass. 806 (1993), cert. den. -- U.S. -- , 128 L. Ed. 2d 191 (1994).[2] A. 1. The Board granted that motion. A. 1-2. The veterans appealed and the Supreme Judicial Court granted direct review. A. 4. On December 26, 1995, the Supreme Judicial Court ruled against the veterans. A. 3-8.

Finally it is not disputed that Massachusetts provides a "complete exemption from taxation of all of the retirement benefits" of every retired state and municipal employee. Filios, 415

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2. Filios was a test case brought by a number of veterans and spouses raising many of the issues raised here. Of course the denial of certiorari in Filios has no precedential significance. See, e.g., Maryland v. Baltimore Radio Show, 338 U.S. 912, 919 (1950) (Frankfurter, J. dissenting from denial of certiorari). Reliance on the denial in Filios would be particularly unwarranted since Respondent opposed certiorari in that case (No. 93-1145) on timeliness, as well as substantive, grounds.

Mass. at 810.[3] Thus while every federal military retiree pays full state income tax on his or her retirement benefits, every state and local retiree's benefit is completely exempt from that tax.

SUMMARY OF ARGUMENT

Petitioners' case is based on one stark fact. Massachusetts requires federal military retirees to pay state income tax on retirement benefits which they receive from the United States while it exempts from that tax the retirement benefits received by all state and municipal retirees. That discrimination is not justified by "significant differences" between the two categories of retirees and therefore it violates the anti-discrimination rule of 4 USC § 111.

Petitioners first point to a number of state laws which expressly grant income tax exemptions to certain state and local retirees who entered employment before 1938. While that explicit favoritism affects relatively few state retirees, by itself it is sufficient to trigger section 111.

Second, and more generally, petitioners point to the state's policy of exempting from tax the non-contributory "pensions" which state and local retirees receive. Those pensions, which amount to 90% of the total retirement benefit, are identical in every way to military retirement benefits and their exemption from tax is a second, and broader, discrimination against federal retirees.

Finally, petitioners note that actual post-tax "contributions" made by employees to the state retirement system constitute such an infinitesimal fraction of the system's funds as to make the state and federal systems functionally equivalent. Thus there are not

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3. Below the court referred to a 15 year-old administrative ruling which suggested that a "non-contributory pension received by a retired [state] employee" would be taxable. 421 Mass at 559, A. 5. However, as discussed below, contrary to the court's dictum, non-contributory "pensions" received by state retirees are <u>not</u> taxed.

sufficient "significant differences" between the two systems which would justify differential tax treatment in light of section 111.

REASONS FOR GRANTING THE WRIT

I. 4 USC § 111 PROHIBITS A STATE FROM TAXING MILITARY RETIREMENT BENEFITS WHEN IT DOES NOT TAX STATE AND MUNICIPAL RETIREMENT BENEFITS.

A. Davis, Barker, Reich and the Significant Differences Requirement

This case involves the legality of Massachusetts' policy of taxing the retirement benefits of retired federal military personnel while it exempts from tax retirement benefits received by retired state and municipal employees. In Massachusetts all military retirees pay a state income tax on their retirement benefits while all state and municipal retirement benefits are exempt from that tax. That discrimination violates the terms set by Congress when it gave the states authority to tax federal employees.

The law on this point was recently restated when, speaking for a unanimous Court, Justice O'Connor wrote:

> For many years, numerous states . . . exempted from state personal income tax retirement benefits paid by the State, but not retirement benefits paid by the Federal Government . . . . In March 1989, this Court held that such a tax scheme violates the constitutional intergovernmental tax immunity doctrine, which dates back to McCulloch v. Maryland, 4 Wheat (17 U.S.) 316 (1819), and has been generally codified at 4 U.S.C. §111. See Davis v. Michigan Dept. of Treasury, 489 U.S. 803 (1989).

Reich v. Collins, 513 U.S.--, 130 L. Ed. 2d 454, 457 (1994)

Section 111 represents a Congressional decision to partially

cede the federal government's absolute constitutional immunity from state taxation of its employees. That concession was made subject to the express condition that such taxation must be equitable; states may not tax federal employees more onerously than they tax their own employees. Thus the United States consents to state taxation of its officers' and employees' compensation, but only ". . . if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation." 4 USC §111.

That principle has been developed in two recent cases in which this Court struck down state efforts to discriminate in favor their retirees. See Davis v. Michigan Dept. of Treasury, 489 U.S. 803 (1989); Barker v. Kansas, 503 U.S. ___, 118 L.Ed. 2d 243 (1992). In Davis the Court held that the non-discrimination clause of section 111 applies to retirement benefits paid to retired federal employees and that individual retirees could sue to obtain the protection of that clause. 489 U.S. supra at 808-810, 814-15. The Court rejected the state's argument that the allegedly more generous benefits federal retirees receive was a "significant difference" that justified its discrimination between state and federal employees. It found that the state's argument that federal employees receive more generous retirement benefits than state employees, even if true, did not warrant a "blanket exemption" for state retirement benefits which favored them over federal workers. Id. at 817. As Justice Kennedy wrote:

> The danger that a State is engaging in impermissible discrimination against the Federal Government is greatest when the State acts to benefit itself and those in privity with it. . . . Taxes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar.

489 U.S. at 815, n.4

In 1992 in Barker, the Court restated its Davis holding that, in applying section 111, the appropriate inquiry is "whether the inconsistent tax treatment is directly related to, and justified by, significant differences between the two classes." 118 L. Ed. 2d at 249 (citation omitted)(emphasis supplied). It concluded military retirees are protected by section 111 and it reversed a decision by the Kansas Supreme Court that there were significant differences between federal military and state civilian retirees. Id. at 254.[4]

Both Davis and Barker focus on differences in how the state treats federal and state retirees. A tax that favors state retirees over federal retirees violates intergovernmental immunity even if the latter are treated no worse than private retirees. The veterans contend here that Massachusetts' laws, facially and as applied, favor state and municipal retirees. As discussed below, Massachusetts has not met its burden of showing that that favoritism is justified by "significant differences" between the two groups.

In Filios, the Supreme Judicial Court held that there were "significant differences" between federal military retirees and state retirees such that differential treatment did not offend section 111. See 415 Mass. at 809. Apparently the court has now reconsidered its approach. In the instant case the same judge who decided Filios refused to decide whether sufficient "significant differences" do exist. See 421 Mass. at 562, n.5; A. 8. Instead the court rested its holding on a different point, a conclusion that "the statute does not discriminate against the [federal] officer or employee because of the source of the pay . . " Id.(Emphasis added).

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4. In Barker the Court noted that while the Kansas Supreme Court had observed that state retirees contribute to their retirement funds while military retirees do not, it did not base its holding of a "significant difference" on that point. Id. at 254, n. 5. The contributory/non-contributory issue thus was not decided in Barker. See Filios, 415 Mass. at 809, n.5.

That approach is doubly flawed. First, the veterans are not challenging Mass. G.L.c. 62, §2(a)(2)(E), the law the Commissioner and the lower court relied upon.[5] Rather they challenge the impact of an package of laws and interpretations which has the effect of treating them in a fashion worse than every state and local retiree.

Second, the Massachusetts court simply misapplies the applicable "discrimination" test. There is no suggestion in either Davis or Barker that for discrimination to violate section 111, there must be a showing of anti-federal animus or a deliberate legislative intent to punish federal workers. Rather, as Justice Stevens noted in another context, in applying a law like section 111 which does not define discrimination, ". . . the sensible test for prohibited discrimination" is to focus "on whether the protected class is being treated substantially less favorably than most similarly situated persons . . . " See Department of Revenue v. ACF Industries, Inc. --U.S.--, 127 L. Ed. 2d 165, 181 (1994)(Stevens, J. dissenting). Davis teaches that for purposes of section 111, state retirees comprise the "similarly situated persons"[6]. As noted above, it is undisputed that, when it comes to Massachusetts' income tax, military retirees are certainly treated "substantially less favorably." Thus, despite the lower court's reticence, the dispositive issue here is whether the state has shown a "significant difference" between the retirement benefits of state workers and federal military retirees

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5. The veterans concede that facially that statute treats recipients of federal and state retirement benefits identically. But the issue raised here is that the ultimate difference in tax treatment accorded to those two categories of retirees is not a simple consequence of that statute, but reflects a clear commitment by Massachusetts to exempt all retirement benefits received by its retirees, regardless of what that statute or other provisions of state law would otherwise call for.

6. The situation is somewhat different in connection with the veterans' first argument which involves the significance of the state's statutory exemption for non-contributory pensions of a class of employees who entered state service before 1938.

which justifies exempting the one while taxing the other?

B. The Statutory Tax Exemption for State, But Not Federal, Retirement Benefits Violates 4 USC §111.

As discussed below, the heart of the Massachusetts' position is that the key distinction in state law is not between federal and state retirees but between "contributory" and "non-contributory" pension systems. See, e.g., 421 Mass. at 559, A. 5. But the validity of that distinction need not be addressed, because Massachusetts' law also still reflects a long-standing, explicit state policy of absolutely exempting certain state and local pensions from tax.

From enactment of the first Massachusetts income tax, the state exempted pensions received by Boston teachers and local police and firemen. Filios, 415 Mass. at 811. In 1973 the legislature provided that "[n]otwithstanding any general or special law to the contrary, income from a noncontributory annuity or pension allowance . . . shall be exempt from taxation under [the income tax.]" Id. This law remains in effect. These exemptions demonstrate that Massachusetts expressly favors some of its retirees over federal retirees, exactly what federal law prohibits. See Davis, 489 U.S. at 815, n.4.

In Filios the Massachusetts court responded to this showing of favoritism by changing the issue. It held that the relevant point was that the state's laws, taken together, do not deny to federal employees generally any favorable treatment they give to state and local government employees. Id. at 811-12. The court cited no authority for adding that gloss to Barker and Davis. It criticized the veterans for presenting no evidence as to which and how many state or local retirees benefit from these exemptions, id. at 811, and held that without such evidence it could not find there were any such employees, opining "it is unlikely [such employees] were numerous, or . . . will survive long enough to require legislative action to remove their more favorable treatment." Id. at 811-12.

That evidentiary problem has now been resolved. As Supreme Judicial Court realized in the instant case, "because the taxpayers' claims were dismissed without a hearing, we must assume that the taxpayers could prove the existence of such retirees." 421 Mass. at 562, n.4; A. 8. The court therefore fell back on its alternative Filios argument, namely that because the class of retirees which the state favors was "small and dwindling" section 111 was not violated. Id., citing Brown v. Mierke, 191 W. Va. 120, cert. den. -- U.S. --, 130 L. Ed. 2d 136 (1994).

That argument finds no support in Davis or Barker. Neither case required federal retirees to show how many state workers were in the favored class or that "actual discrimination" was being practiced. Even if only a limited number of retirees still benefit from Massachusetts' statutory favoritism, the resulting discrimination is unambiguous. In enacting 4 USC §111, Congress granted states the privilege to tax federal employees but only on a strict condition of non-discrimination.[7] Since the state does not

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7. Neither Davis nor Barker suggests how to measure discrimination barred by section 111. Cases in other areas suggest two tests. The first, and stronger, finds that a state discriminates against those associated with the federal government if "it treats someone else better than it treats them." Washington v. United States, 460 U.S. 536, 545 (1983) (emphasis added). Application of that rule "does not depend upon the amount of the exaction, the weight of the burden or the extent of the resulting interference with sovereign independence. Where it applies, the principle is an absolute one wholly unaffected by matters or distinctions of degree." TrinityFarm Construction Co. v. Grosjean, 291 U.S. 466, 471 (1933)(emphasis added). Application of the "most favored taxpayer" test to section 111 would require a ruling in the veterans' favor.

The second test is "the sensible test for prohibited discrimination" proposed by Justice Stevens in Department of Revenue v. ACF Industries, Inc. --U.S.--, 127 L. Ed. 2d 165, 181 (1994). That test looks at "whether the protected class is being treated substantially less favorably than most similarly situated persons . . . ." The

meet that condition, it has lost the privilege granted by section 111.

C. Exempting State, But Not Federal, Non-Contributory "Pension" Benefits Is Prohibited By 4 U.S.C. §111.

The veterans do not rely solely on those Massachusetts laws which expressly exempt some state retirement benefits from tax. The second reason why Massachusetts is illegally discriminating against them is the state's practice of exempting from state tax the non-contributory "pensions" received by every state retiree. The Supreme Judicial Court's only response to that issue was to rely on Mass. G.L.c. 62, §2(a)(2)(E)("section 2E") which exempts from state tax income from "any contributory annuity, pension, . . . or retirement fund . . . to which the employee has contributed." 421 Mass. at 558; A. 4(Emphasis added). It held that the Commonwealth's pension "system" is "contributory" while the federal military pension system is "non-contributory." That distinction, it held, is "dispositive" and enough to pass muster under section 111. 421 Mass. at 560; A. 6.

The first flaw in the court's reasoning is that the Massachusetts public retirement program is not the simple one-dimensional "system" that its opinion suggests. By law each employee's retirement benefit has two components, an "annuity" derived from employee contributions and a "pension" which comes exclusively from "contributions made by the appropriate governmental unit." See Mass. G.L.c. 32, §1, ¶¶ 8,30; see also 421 Mass. at 559, A. 5. Furthermore, although the lower court did not discuss it, the "annuity" and the "pension" are each paid from a

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veterans concede that that rule, if applicable, does not aid this aspect of their case. However, as discussed below, since the ultimate issue here is the total exemption of all state retirement benefits and total taxation of all military retirement benefits, their other claims meet even this more stringent test.

separate "**fund.**" See Mass. G.L.c. 32, §1, ¶11(annuity savings fund), ¶31(pension fund). Throughout this litigation it has been conceded that the state exempts from tax the entirety of all income received by state and local retirees, not just portion of that income which reflects their contributory "annuity" paid from the annuity fund. Exemption of state retirees' "pension" benefits cannot be defended by reference to section 2E because the pension does not come from a "fund" to which the employee contributed.[8]

The court's response to this was to dismiss the veterans' position as not substantive but "technical." 421 Mass. at 559; A. 5. In a judicial tour de force, the court held that what is "dispositive" is "whether the employee contributed to the retirement system, not what account his contributions are put in, or from what account distributions are made." 421 Mass. at 560; A. 6. But as quoted above, that is simply not a correct statement of section 2E which refers to "funds" not "systems." Massachusetts' defense for exempting from tax the retirement benefits its state workers derive from non-contributory pension funds therefore cannot be based on section 2E's facially neutral language.

Yet Massachusetts does exempt benefits from the "non-contributory" pension fund. Indeed that non-contributory "pension" comprises some 90% of state employees' retirement benefits. See 415 Mass. at 811. The contributory/non-contributory dichotomy, the sole basis on which the court below relied, is thus irrelevant to these "pension" benefits which are solely derived from employer-supplied funds. Plainly there is no difference, let alone a "significant" one, between income a state retiree receives from his non-contributory "pension" and the equally non-contributory

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8. The lower court misspoke when it noted in dicta, 421 Mass. at 560; A. 6, that the "preretirement employee pays into the pension fund a percentage of after-tax wages . . . . " (Emphasis added). As noted above, all contributions go to the annuity savings fund while the pension fund consists solely of employer contributions. Mass. G.L.c. 32, §1, ¶¶ 11, 31.

retirement income received by a veteran. To paraphrase the lower court's discussion of the veterans' situation, with respect to their pensions, state workers "are beneficiaries of a 'noncontributory' system funded entirely by their former employer . . . ." 421 Mass. at 558; A. 4.

Furthermore, the state cannot defend exempting non-contributory "pensions" from tax on the ground that its retirees also receive an additional 10% in the form of a contributory "annuity." First, as noted in Davis, that would only justify exempting the contributory portion of benefits state retirees receive, not the "blanket" exemption the state actually gives them. Davis, 489 U.S. supra at 817. Second, such a system of derivatory exemptions would also be discriminatory, and violate section 111. Military retirees do not have a comparable opportunity to shelter their non-contributory retirement benefits from state tax by mixing them with contributory annuity benefits at a ratio of nine parts to one.

Massachusetts' policy of exempting its retirees' non-contributory "pension" benefits while taxing veterans' non-contributory retirement benefits clearly discriminates against federal employees. The state has failed to show that this disparate treatment is " . . . directly related to, and justified by, significant differences between the two classes" Davis, 489 U.S. supra at 816. Therefore, it is violating the plain language of 4 USC § 111 and it is not longer entitled to exercise the Congressionally granted privilege of taxing veterans' retirement benefits.

This is not a "technical" quibble based on the state's "accounting system." Cf. 421 Mass. at 560; A. 6. The favoritism the veterans challenge here does not involve only a few elderly retired firemen. It involves each and every retired state and local worker[9] and it is a stark case of favoring retirement benefits

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9. Thus this case is on all fours with Barker in which Kansas exempted every state retiree while taxing every military retiree. See 128 L. Ed. 2d at 248. On the other hand it is quite different from

received by state workers as against those of federal workers. It is a flat and blatant violation of section 111.

D. Differences Between the Massachusetts' Retirement System and the Federal Military System are Not Sufficient for the State To Satisfy 4 USC §111.

Even if Massachusetts were allowed, contrary to the language of section 2E, to shelter its retirees' noncontributory "pensions" behind the umbrella of its "contributory" system, it would not survive section 111 challenge. Regardless of the label the state and the lower court have chosen to affix to the Massachusetts' retirement system, as a matter of clear and unambiguous fact, in practical operation that system is so effectively similar to the military system that, in light of section 111, the state cannot justify taxing the two systems differently.

Massachusetts has a unique form of "contributory" retirement system. In 1987, the state amended Mass. G.L.c. 32, §22(10), so its employees no longer make any contributions, as that term is normally understood, to their retirement systems. As amended, section 22(10) now provides in part:

> Each government unit . . . shall . . . pay the contributions which would be payable by the employees as members . . . . Such contributions, although designated as employee contributions, will be paid by the applicable governmental unit . . . in lieu of contributions by the employee . . . . The contributions so assumed shall be treated as employer contributions in determining tax treatment under the United States Internal Revenue Code. The contributions so assumed shall be treated and identified . . . as member contributions for purposes of the retirement system . . . and

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Brown v. Mierke, 191 W. Va 120, 124, cert. den. 130 L. Ed. 2d 136 (1994) cited below (A.8) where West Virginia exempted from tax "less than four percent of all State government retirees."

for all purposes of chapter sixty-two [the state income tax].

Thus the lower court's statement, 421 Mass. at 560; A.6, that preretirement employees pay into the retirement system a portion of after-tax wages, while in a non-contributory system "the preretirement employee sacrifices nothing and receives full salary" is somewhat misleading. Massachusetts employees no longer pay any current federal income tax on their "contributions." 26 U.S.C. §414(h)(2). While state workers do pay state income tax on their contributions,[10] the tax paid on "contributions" is further reduced by the $2000 statutory deduction in Mass. G.L.c. 62, §3(B)(a)(4) which effectively shields employees earning less than $25,000 from ever paying any tax, state or federal, on their "contributions."[11]

Altogether then, given the small impact of state income taxes as compared to federal taxes with their higher marginal rates, if "contributory" is given its common sense meaning, Massachusetts

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10. Because Massachusetts uses the federal definition of "gross income" to define income for tax purposes under Mass. G.L.c. 62, §2(a), state employees would normally escape paying any state income tax on their retirement "contributions." But when its own revenues are involved, the state is less willing to accept its legal fictions. Taxpayers must add back into adjusted state income "contributions" excluded from federal gross income. See Mass G.L.c. 62, §2(a)(1)(I).

11. The lower court took pains to point out that employees hired after 1984 and earning over $25,000 do begin to pay some state tax on their contributions. See 421 Mass. at 561; A. 7. Given that Massachusetts' marginal tax rate is under 6%, the court's failure to quantify how much tax those workers pay is understandable. It is instructive to compare the lower court's pragmatic rejection of the veterans' first argument concerning the exemption for pre-1938 employees on the grounds that there were too few of them to make a difference with its exaltation of even one dollar of state tax paid by some employees as a sufficient "sacrifice" to justify a complete, lifetime exemption for the entirety of all state retirees' benefits.

has not had a "contributory" retirement system since 1987.

But for this Court's purposes, the key issue is that, to use the lower court's own word, state employees make very little "sacrifice" in return for their tax-free retirement benefits.[12] In light of the almost total tax protection the state provides to employee "contributions," whether or not the state system is "contributory," the differences between it and the "non-contributory" military retirement system are simply not "significant" enough to justify the total difference in tax treatment. See Davis, supra.

Plainly Massachusetts wishes to have its cake and eat it too. It classifies contributions to state and local retirement funds as employer contributions when that works to employees' advantage and classifies them as employee contributions when that, diametrically opposite, conclusion works to their advantage. This distortion of the state's tax laws in order to "benefit itself and those in privity with it" is just the sort of scheme to reduce state employment costs which Justice Kennedy held is barred by section 111. Davis, 489 U.S. supra at 815, n.4.

E. The Double Taxation Red Herring.

Finally, the veterans wish to briefly discuss the "double taxation" argument noted with apparent approval in Filios, supra at

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12. Indeed, the lower court's decision verges on recognizing that the state's rationale for the exemption is a verbal sleight of hand. The decision notes, 421 Mass. at 561, n.3; A. 7, that the exclusion under section 2E "does not turn on whether the employee contributions were taxed by the Federal government, but on whether the contributions were made in the first place." But a "contribution" made by the employer on which no taxes are ever paid is no "contribution" at all and is indistinguishable from how the federal government funds military retirement benefits. A state cannot avoid section 111 by simply relabeling its own payments to its retirement system as "contributions."

810. That argument, that exemption of the entirety of state and local retirement benefits from state income tax is needed to prevent double taxation of employee contributions, was wisely not raised by the court in Cooper. In any event, it is plainly wrong even if the analysis is narrowed to look solely at the minute share of retirement benefits traceable to taxable employee "contributions."

Federal law already exempts from gross income the portion of retirement benefits which reflects a return of a retiree's contributions. See 26 USC §§ 61, 72; Heard v. Commissioner, 326 F. 2d 962 (8th Cir. 1964)(income tax only on income in excess of contribution). The state's reliance upon the federal definition of gross income, Mass. G.L.c. 62, §2(a), automatically imports that exclusion into the state income tax system.

Thus the only effective function of the section 2E exemption is to exempt from state tax the remaining part of retirement benefits which has not already been excluded, namely that part of a retiree's check which does not reflect return of his or her contributions. Once more therefore the "contributory" language of section 2E acts as no more than a flag of convenience behind which the state can carry out its program of providing blanket tax protection to its retirees' benefits.

CONCLUSION

Petitioners do not challenge Massachusetts' right to exempt from tax its workers' retirement benefits. Contrary to the suggestion below, 421 Mass. at 560; A. 6, they do not ask the state to tax its retirees or to change its retirement system. Rather, because section 111 promises them fairness in state taxation of their federal retirement benefits, they challenge Massachusetts' practice of taxing their retirement benefits while continuing to exempt from that tax all retirement benefits received by state and local retirees.

The only constancy in the state's justifications for its

actions is their mutability.[13] When the veterans asked the court below to consider the plain fact that all state retirement benefits are tax exempt, while all military retirement benefits are taxed, it looked only to the facial neutrality of the law as it stands on the statute books. When the taxpayers opened those books to point to laws that expressly exempt some non-contributory benefits, the court dismissed that by claiming those laws apply to a "small and dwindling class" (of few hundred or thousand). When the veterans noted that state law provides that 90% of the benefit each state retiree receives is a non-contributory, but tax-exempt, "pension," it found concern over such "technical distinction[s]" "misplaced." 421 Mass. at 559; A. 5. The common thread is the state's determination to exempt its retirees from tax while fully taxing federal military veterans.

To quote from the amicus brief which the United States filed with the Supreme Judicial Court below, "Massachusetts's facially discriminatory taxation of military retirement benefits lacks any coherent or consistent rationale. It is therefore invalid under 4 USC § 111." Brief of the United States as Amicus Curiae in Cooper v. Commissioner, No. 6747 at 8. Two years ago in Filios, the Solicitor General warned that "[i]f the decision in this case were allowed to stand, it would serve as a guidepost for States seeking to circumvent the clear restrictions imposed by 4 U.S.C. 111 and this Court's prior decisions." Brief for the United States as Amicus Curiae in Filios v. Commissioner of Revenue, No. 93-1145 at 8. That danger has, if anything, worsened with the passage of time.

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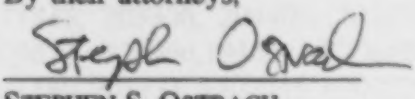
13. With apologies to the philosopher Heraclitus.

For the foregoing reasons, petitioners request that their application for a writ of certiorari be granted and that, after hearing, the December 26, 1995 decision of the Supreme Judicial Court of the Commonwealth of Massachusetts be reversed.

Respectfully submitted,
Leland A. Cooper et al.
By their attorneys,



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DATED: Boston, Massachusetts: March 20, 1996.

The Commonwealth of Massachusetts
Appellate Tax Board

Leverett Saltonstall Building, Government Center
100 Cambridge Street, Boston 02202

Docket Nos. 171116-171117, 171959, 171472, 171883, 203306, 204400, 204675-204677, 179066,191604, F206610, 191580, 203737, F207945, F207727, F207983, F208676, F210391, F211152, F211150-F211151, 213952, F215204, F207669, 179525, 178617, F214556, 171320, 177931, 179486, 198062, F212998

LELAND COOPER, et al.

v.

COMMISSIONER OF REVENUE

DECISION

The Appellee's motion for judgment on the pleadings is granted.

The parties have raised no issue of law or fact that were not addressed and disposed of by the Supreme Judicial Court in Filios v. Commissioner of Revenue, 415 Mass. 806 (1993), cert. den. 128 L. Ed. 191, affirming the Board's Decision and subsequent Findings reported in 14 Mass. A.T. B. Rep. 77 (Docket Nos. 171106 et al., July 1, 1992).

Decision for the Appellee.

APPELLATE TAX BOARD

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Date: August 26, 1994

LELAND COOPER & others[1] *vs.* COMMISSIONER OF REVENUE.

Suffolk. September 13, 1995. - December 26, 1995.

Present: LIACOS, C.J., ABRAMS, LYNCH, & O'CONNOR, JJ.

Taxation, Income tax, Abatement. *Constitutional Law*, Income tax. *Retirement.*

Where Massachusetts tax law distinguishes between contributory and noncontributory retirement plans, taxing as income distributions of benefits from the latter but exempting the former, and treats retirement benefits paid by the Commonwealth and by the Federal government in the same manner for tax purposes, neither G. L. c. 62, § 2 (*a*) (2) (E), nor St. 1973, c. 876, violates 4 U.S.C. § 111 (1994), with the result that Massachusetts residents who paid State income taxes on Federal military pension income from 1986 to 1992 were not entitled to an abatement inasmuch as that retirement system was noncontributory. [558-562]

APPEAL from a decision of the Appellate Tax Board.

The Supreme Judicial Court granted an application for direct appellate review.

Stephen S. Ostrach for the taxpayers.

Douglas H. Wilkins, Assistant Attorney General (*Thomas A. Barnico*, Assistant Attorney General, with him) for the Commissioner of Revenue.

Loretta C. Argrett, Assistant Attorney General, *Gary R. Allen, David English Carmack & Kevin M. Brown*, of the District of Columbia, for The United States, amicus curiae, submitted a brief.

ABRAMS, J. The plaintiff taxpayers appeal from the Appellate Tax Board's dismissal on the pleadings of their claims for abatement of State income tax paid on Federal retire-

[1]Twenty-seven other taxpayers.

ment benefits. They urge us to overrule *Filios* v. *Commissioner of Revenue*, 415 Mass. 806 (1993), cert. denied, 114 S. Ct. 1538 (1994). We allowed the plaintiffs' application for direct appellate review. We affirm.

The taxpayers are Massachusetts residents who paid State income taxes on Federal military pension income from 1986 to 1992. Their abatement claim is grounded in 4 U.S.C. § 111 (1994), which provides: "The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . or political subdivision thereof . . . by a duly constituted taxing authority . . . if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation." Where State law imposes a heavier tax burden "because of the source of the pay or compensation," § 111 is violated unless "the inconsistent tax treatment is directly related to, and justified by, 'significant differences between the two classes.'" *Barker* v. *Kansas*, 503 U.S. 594, 598 (1992), quoting *Davis* v. *Michigan Dep't of the Treasury*, 489 U.S. 803, 816 (1989). The taxpayers here argue that 4 U.S.C. § 111 is violated by G. L. c. 62, § 2 (*a*) (2) (E) (1994 ed.), and by St. 1973, c. 876. We do not agree.

General Laws c. 62, § 2 (*a*) (2) (E), exempts "[i]ncome from any contributory annuity, pension, endowment or retirement fund of the United States government or the commonwealth or any political subdivision thereof . . . to which the employee has contributed." Under the statute, benefits received by employees who contributed to the pension system during their State or Federal employment are exempt from State taxation, and employees (whether State or Federal) who did not contribute a portion of their salary to the retirement system must pay State taxes on their benefits. Most employees of the Commonwealth pay a percentage of their salaries into the retirement system during their working years. G. L. c. 32, § 22 (1994 ed.). The taxpayers, on the other hand, are beneficiaries of a "noncontributory" system funded entirely by their former employer, the Federal government. The Commissioner of Revenue asserts that the tax-

payers' pension benefits are therefore taxable under G. L. c. 62, § 2 (*a*) (2) (E). The taxpayers claim that the statute violates 4 U.S.C. § 111. We agree with the commissioner.

Massachusetts tax law distinguishes between contributory and noncontributory retirement plans, not between State and Federal retirees. "The determining factor for the Massachusetts exemption is whether the retirement fund is a 'contributory fund to which the employee has contributed.' " Technical Information Release (TIR) 89-6 (May 10, 1989), 2 Official MassTax Guide at 369 (West 1995). "Any Federal retirement income is exempt from Massachusetts tax if the system is contributory and the employee actually contributed," *id.*,[8] and, on the other hand, "[a] non-contributory government pension, received by a retired employee of [a political subdivision of the Commonwealth] . . . is includible in the Massachusetts gross income of the employee . . . in the taxable year in which the pension is paid." Letter Ruling 81-51 (June 11, 1981), *supra* at 576. In sum, the statutory provisions treat retirement benefits paid by the Commonwealth and the Federal government in precisely the same way.

The taxpayers argue that a retired employee of the Commonwealth receives "annuity" payments from the employee's own contributions and "pension" payments from the Commonwealth's contributions, so that the State employee does not contribute to the "pension fund." The taxpayers conclude that to tax their pension benefits is discriminatory because the State retiree is receiving a State tax-free "pension." If the taxpayers were correct we would be required to interpret G. L. c. 62, § 2 (*a*) (2) (E), so as to yield different results depending not on the substantive distinction whether employees contribute, but rather on the technical distinction of how

[8]Accord TIR 78-1 (Jan. 9, 1978) 2 Official MassTax Guide at 309 (West 1995) ("Income received from an employee benefit plan is generally taxable . . . . An exception is provided for amounts received from any annuity, pension, endowment or retirement fund of the United States government or the Commonwealth . . . to which the employee has contributed . . .").

the Commonwealth accounts for contributions. We conclude that the taxpayers are not correct, and that their focus on the State's accounting system is misplaced. The dispositive inquiry under G. L. c. 62, § 2 (*a*) (2) (E), is whether the employee contributed to the retirement system, not what account his contributions are placed in, or from what account distributions are made. The State worker is required to make regular, State-taxed, contributions to the retirement system in order to get a State tax-free pension on retirement. The taxpayers here made no such contribution.

Further, the result advocated by the taxpayers would require the Commonwealth either to discriminate against contributing employees in favor of noncontributing employees by taxing both contributions when made and benefits when received or, alternatively, to make the State retirement system noncontributory so as not to favor noncontributing employees. We do not think "the modern constitutional doctrine of intergovernmental tax immunity" codified in 4 U.S.C. § 111 requires such a result. *Davis* v. *Michigan Dep't of the Treasury*, 489 U.S. 803, 813 (1989).

We also do not agree with the taxpayers that the distinction made by the Commonwealth between contributing and noncontributing employees is "only a cloak for discrimination against federally funded benefits." *Barker*, *supra* at 604-605. Disparate treatment is justified by the fact that, in the Commonwealth's contributory system, the preretirement employee pays into the pension fund a percentage of after-tax wages, while in a noncontributory system the preretirement employee sacrifices nothing and receives full salary.[3]

[3]Employee contributions are subject to State tax pursuant to G. L. c. 62, § 2 (*a*) (1) (I). They are designated "employer contributions" by G. L. c. 32, § 22 (10), for Federal income tax purposes, not to exempt the employee from taxation, but to defer Federal taxation until benefits are received. See 26 U.S.C. § 414(h); *Howell* v. *United States*, 775 F.2d 887, 889-890 (7th Cir. 1985).

Because such designation and deferral of Federal taxation is specifically authorized by 26 U.S.C. § 414(h), it is difficult to understand the taxpayers' argument that such designation evidences discrimination violative of 4 U.S.C. § 111. We note, at any rate, that exclusion under G. L. c. 62,

Furthermore, we do not agree with the taxpayers that the contribution of a Massachusetts State employee is illusory. General Laws c. 32, § 22 (1) (*b*), requires a contribution of five per cent from employees who began service prior to 1975, seven per cent from employees who began service between 1975 and 1984, and eight percent from employees who began service after 1984. General Laws c. 32, § 22 (1) (*b*½), requires an additional two per cent of the salary in excess of $30,000 from employees who began service after 1978. Although G. L. c. 62, § 3 (B) (*a*) (4), allows a taxpayer to deduct up to $2,000 from gross income for retirement system contributions, the taxpayers are mistaken in asserting that this provision "effectively shields employees earning less than $40,000 from ever paying any tax on their 'contributions.' " On the contrary, as the commissioner points out, a State employee hired after 1984 and earning between $25,000 and $30,000 (and therefore subject only to the eight per cent rate) would be subject to tax despite the $2,000 deduction. For State employees earning over $30,000 (and who are therefore subject to the additional two per cent contribution required by G. L. c. 32, § 22 [1] [*b*½]), the tax is even more significant.

The taxpayers also argue that 4 U.S.C. § 111 is violated by St. 1973, c. 876. Chapter 876 is a "grandfather" provision which exempts from taxation "income from a noncontributory annuity or pension allowance received on account of service in a police or fire department of a town by a person . . . who was in the employ of such . . . department at the time of the establishment of the contributory retirement system" in 1936 and 1937.[4] We do not think this provision dis-

§ 2 (*a*) (2) (E), does not turn on whether the employee contributions were taxed by the Federal government, but on whether the contributions were made in the first place.

[4]The contributory system was established by St. 1936, c. 318 and St. 1937, c. 336. To receive the favored treatment about which the taxpayers complain, one would have had to be employed by a Massachusetts police or fire department before 1938, declined to join a contributory plan, and received benefits from a noncontributory plan from 1986 to 1992.

criminatory in the meaning of 4 U.S.C. § 111. Chapter 876 favors a class of retirees not "because . . . the source of the pay or compensation" is the Commonwealth rather than the Federal government, but on the basis of occupation (police and firefighters) and date of first employment (before 1938). Furthermore, St. 1973, c. 876, protects a small and dwindling class; we do not think it can be credibly argued that it constitutes "discrimination against federally funded benefits." *Barker*, *supra* at 604-605. Accord *Brown* v. *Mierke*, 191 W.Va. 120, 124, cert. denied sub nom. *Brown* v. *Paige*, 115 S. Ct. 207 (1994) (distinguishing statutes which discriminate *against* Federal retirees from statute *favoring* a narrow class of State retirees). See also *Alarid* v. *Secretary of the N.M. Dep't of Taxation & Revenue*, 118 N.M. 23, 29 (Ct. App. 1994), cert. denied, 115 S. Ct. 733 (1995) (same).

Neither G. L. c. 62, § 2 (*a*) (2) (E), nor St. 1973, c. 876, discriminates on the basis of source of benefits, either facially or in effect. Therefore, neither statute violates 4 U.S.C. § 111.[8] The taxpayers' argument amounts to a request that Federal employees be treated better than State and local employees. We do not think that 4 U.S.C. § 111 requires such a result. The ruling of the board is affirmed.

So ordered.

In *Filios*, we expressed doubt that any such person existed. See *id.* at 811-812. We noted, at any rate, that the taxpayer had failed to produce one, and so could not prove discriminatory treatment. *Id.* Here, because the taxpayers' claims were dismissed without an evidentiary hearing, we assume that the taxpayers could prove the existence of such retirees.

[8]Because we conclude that the statute "does not discriminate against the officer or employee because of the source of the pay or compensation," 4 U.S.C. § 111, we need not address the parties arguments as to whether the alleged inconsistencies are "justified by, 'significant differences between the classes.'" *Barker* v. *Kansas*, 503 U.S. 594, 598 (1992), quoting *Davis* v. *Michigan Dep't of the Treasury*, 489 U.S. 803, 816 (1989).